



8011-01

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-87470; File No. SR-FINRA-2019-022]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 1, to Amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions)

November 5, 2019

I. Introduction

On July 26, 2019, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions) to exempt additional persons and offerings, modify current exemptions to enhance regulatory consistency, and address unintended operational impediments. The proposed rule change was published for comment in the Federal Register on August 8, 2019.³ The Commission received six comment letters on the proposal.⁴ On September 10, 2019, FINRA extended the time period in which the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 86558 (August 2, 2019), 84 FR 39029 (August 8, 2019) (Notice of Filing of File No. SR-FINRA-2019-022) (“Original Notice”).

⁴ See Letter from Robert E. Buckholz, Chair, Federal Regulation of Securities Committee, American Bar Association Business Law Section, to Vanessa Countryman, Secretary,

Commission must approve the proposed rule change, disapprove the proposed rule change or institute proceedings to determine whether to approve or disapprove the proposed rule change to November 6, 2019.

On October 30, 2019, FINRA responded to the comments and filed Partial Amendment No. 1 to the proposal.⁵ The Commission is publishing this notice to solicit comments on Partial Amendment No. 1 from interested persons, and is approving the proposed rule change, as modified by Partial Amendment No. 1, on an accelerated basis.

II. Description of the Proposed Rule Change

A. Description of Proposed Rule Change as Originally Filed

The following is a summary of the proposed rule change as originally filed by FINRA.⁶

As described in more detail in the Original Notice, FINRA proposes to amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions) in response to the comments it received

SEC, dated August 27, 2019 (“ABA”); letter from Elliott R. Curzon, Dechert LLP, to Jill M. Peterson, Assistant Secretary, SEC, dated August 29, 2019 (“Dechert 1”); letter from Dechert LLP, to Jill M. Peterson, Assistant Secretary, SEC, dated August 29, 2019 (“Dechert 2”); letter from Gail C. Bernstein, General Counsel, Investment Adviser Association, to Vanessa Countryman, Secretary, SEC, dated August 29, 2019 (“IAA”); letter from Aseel M. Rabie, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Vanessa Countryman, Secretary, SEC, dated August 29, 2019 (“SIFMA”); and letter from Chris Peterson, to Vanessa Countryman, Secretary, SEC, dated September 13, 2019 (“Peterson”).

⁵ See letter from Afshin Atabaki, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated October 30, 2019 (“FINRA Response”). FINRA Response to comments received and Partial Amendment No. 1 are available at <https://www.finra.org/industry/rule-filings/sr-finra-2019-022>. See also Section II.B., *infra*.

⁶ See Original Notice, *supra* note 3, for a complete description of the proposal as originally filed.

based on Regulatory Notice 17-14,⁷ as well as FINRA’s experience with the Rules 5130 and 5131 (or “the rules”). The proposed rule change would exempt additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments, and exempt certain types of offerings from the scope of the rules.

Family Offices

The proposed rule change would amend FINRA Rule 5130(i)(4) to define a “family investment vehicle” as a legal entity that is beneficially owned solely by one or more of the following persons: (1) “immediate family members” as defined under FINRA Rule 5130(i)(5); (2) “family members” as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(6); or (3) “family clients” as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(4);⁸ provided, however, that where the beneficial owners of such an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity is an “immediate family member” as defined in FINRA Rule 5130(i)(5) or a “family member” as defined in Advisers Act Rule 202(a)(11)(G)-1(d)(6). Where the beneficial owners are not solely immediate family members or family members under FINRA Rule 5130(i)(5) or Advisers Act Rule 202(a)(11)(G)-1(d)(6), respectively, however, the proposed rule change would only provide relief from portfolio manager status if the person who has the authority to buy or sell securities for the account is an

⁷ In April 2017, FINRA published Regulatory Notice 17-14 (Capital Formation) seeking comment on the effectiveness and efficiency of its rules, operations and administrative processes governing broker-dealer activities related to the capital-raising process and their impact on capital formation. FINRA received 11 comment letters in response to the Regulatory Notice. The Regulatory Notice and the comment letters are available at <http://www.finra.org/industry/notices/17-14>.

⁸ The term “family client” includes not only family members but others, including key employees. See 17 CFR 275.202(a)(11)(G)-1(d)(4). Therefore, a family investment vehicle that is beneficially owned solely by family clients may include beneficial owners that are not family members.

“immediate family member,” as defined in FINRA Rule 5130, or a “family member,” as defined in the Advisers Act.⁹

Sovereign Entities

The proposed rule change would exclude sovereign entities from the scope of owners of broker-dealers under Rule 5130(i)(10)(E). The proposed exclusion would not apply to affiliates of sovereign entities that are otherwise restricted. Accordingly, while a sovereign entity that owns a broker-dealer would not be considered a restricted person under the proposed rule change, the broker-dealer would continue to be a restricted person under FINRA Rule 5130.

The proposed rule change would also amend FINRA Rule 5130(i) (Definitions) to define the term “sovereign entity” for purposes of the rule as “a sovereign nation or a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation.” The proposed rule change would further define the term “sovereign nation” as “a sovereign nation or its political subdivisions, agencies or instrumentalities.”

Foreign Employee Retirement Benefits Plans

The proposed rule change would also amend FINRA Rule 5130(c) (General Exemptions) to provide an exemption for an employee retirement benefits plan organized under and governed by the laws of a foreign jurisdiction, provided that such a plan or family of plans: (1) has, in aggregate, at least 10,000 participants and beneficiaries and \$10 billion in assets; (2) is operated in a non-discriminatory manner insofar as a wide range of employees, regardless of income or

⁹ Further, the proposed relief is only with respect to a person’s status as a portfolio manager under FINRA Rule 5130. The proposed relief does not extend to a person who has a beneficial interest in a family investment vehicle and is a restricted person based on his or her other activities, such as an associated person of a member.

position, are eligible to participate without further amendment or action by the plan sponsor;¹⁰ (3) is administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries; and (4) is not sponsored by a broker-dealer. The proposed rule change would also amend Rule 5131(b)(2) to add a corresponding exemption (regarding employee retirement benefits plans) to Rule 5131.

Alternative Conditions for Foreign Investment Company Exemption

FINRA also proposes to amend paragraph (c)(6) of FINRA Rule 5130 to exempt sales to and purchases by an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; (2) no person owning more than five percent of the shares of the investment company is a restricted person, the investment company has 100 or more direct investors, or the investment company has 1,000 or more indirect investors; and (3) the investment company was not formed for the specific purpose of investing in new issues.¹¹

Exclusion for Foreign Offerings

In addition, the proposed rule change would expressly exclude from Rules 5130 and 5131 offerings that are conducted pursuant to Regulation S, which provides a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities, as well

¹⁰ The definition of “broad-based foreign retirement plan” under Section 409A of the IRC includes a substantially similar condition. See 26 CFR 1.409A-1(a)(3)(v)(A). Section 409A imposes restrictions on the deferral of compensation by employees, directors and independent contractors. Section 409A provides an exemption for compensation deferred under certain broad-based foreign retirement plans.

¹¹ The proposed rule change would also impact an identical exemption cross referenced in paragraph (b)(2) of FINRA Rule 5131.

as other offerings made outside of the United States or its territories (i.e., not just those that are expressly designated as Regulation S offerings).

Issuer-Directed Securities

To more closely align FINRA Rule 5130(d) with the issuer-directed provision in Rule 5131.01, the proposed rule change would also amend paragraphs (d)(1) and (d)(2) of Rule 5130 to expand the exemption for issuer-directed securities to allocations directed by affiliates and selling shareholders of the issuer. The proposed rule change would also clarify that the exemption applies to shares that are specifically directed in writing by the issuer.

Exclusion for Unaffiliated Charitable Organizations

The proposed rule change also would amend paragraph (e)(3) of Rule 5131 (Definitions) to exclude unaffiliated charitable organizations, as that term is elsewhere defined in the rule,¹² from the definition of “covered non-public company” so that an executive officer or director of a charitable organization that is not affiliated with the member allocating IPO shares would not become the subject of the rule’s spinning provision solely on the basis of that service.

Addition of Anti-Dilution Provision to FINRA Rule 5131

The proposed rule change would also amend Rule 5131(b)’s spinning provision to add an anti-dilution provision to the rule (similar to the one in Rule 5130(e)), which would allow an executive officer or director of a public company or a covered non-public company (or a person materially supported by such a person) to retain the percentage equity ownership in the issuer at

¹² An “unaffiliated charitable organization” is a tax-exempt entity organized under Section 501(c)(3) of the IRC that is not affiliated with the member and for which no executive officer or director of the member, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (i.e., officers, directors, trustees, key employees, highest compensated employees and certain independent contractors). See FINRA Rule 5131(e)(9).

a level up to the ownership interest as of three months prior to the filing of the registration statement, provided that the other conditions are met.

B. Notice of Partial Amendment No. 1

1. Introduction

Set forth in Section II.B.2 below is the summary of Partial Amendment No. 1 to the proposed rule changes, as prepared and submitted by FINRA to the Commission.¹³

2. Self-Regulatory Organization's Description of the Proposal, as Modified by Partial Amendment No. 1

As discussed in the FINRA Response to comments,¹⁴ Partial Amendment No. 1 makes the following changes to the proposed rule change:

- amends proposed Rule 5130(i)(4) to remove the proposed limitation on portfolio managers of certain family investment vehicles;
- modifies proposed Rule 5130(c)(6) to provide that a foreign public investment company may not be formed for the specific purpose of permitting restricted persons to invest in new issues;
- revises proposed Rule 5130(c)(8) to also exclude employee retirement benefits plans organized in the United States that meet the proposed conditions;
- amends proposed Rule 5130(i)(9) to limit the proposed exclusion for foreign offerings to offerings that do not include shares that are concurrently registered for sale in the United States;

¹³ The text of Partial Amendment No. 1, including Exhibit 4 (which reflects changes to the text of the proposed rule change pursuant to Partial Amendment No. 1) and Exhibit 5, (which reflects all proposed changes to the current rule text, as amended by Partial Amendment No. 1), is available on FINRA's website at: <https://www.finra.org/industry/rule-filings/sr-finra-2019-022>.

¹⁴ See supra note 5.

- adds proposed Rules 5130.01 and 5131.05 to clarify the application of the rules to independent allocations to non-U.S. persons by foreign non-member broker-dealers participating in an underwriting syndicate;
- revises current Rule 5131.01 and proposed Rules 5130(d)(1) and (d)(2) to clarify that the rules apply to securities directed by a single affiliate or a single selling shareholder;
- amends current Rule 5130(d)(1)(B) to expressly recognize employees or directors of affiliated franchisees;
- excepts certain transfers to immediate family members from current Rule 5131(d)(2)(B)'s public announcement requirement;
- amends current Rule 5131.03 to codify existing guidance regarding the disclosure of a release or waiver in a publicly filed registration statement;
- excludes from the definition of “new issue” in proposed Rule 5130(i)(9) offerings of a special purpose acquisition company (“SPAC”);
- modifies proposed Rule 5130(i)(11) to include other types of sovereign investment vehicles; and
- amends proposed Rule 5130(i)(10)(E) to remove the reference to persons listed in Schedule C of Form BD (Uniform Application for Broker-Dealer Registration).

FINRA is also proposing in this Partial Amendment No. 1 to make a technical correction to proposed FINRA Rule 5130(i)(9) to replace the references to offerings made pursuant to Section 4(1), 4(2) or 4(6) of the Securities Act of 1933 (“Securities Act”) with offerings made pursuant to Section 4(a)(1), 4(a)(2) or 4(a)(5) of the Securities Act.

Family Investment Vehicles

Proposed Rule 5130(i)(4) requires that where the beneficial owners of a family investment vehicle include family clients, which may include beneficial owners that are not family members, the person who has the sole authority to buy or sell securities for such an entity must be an “immediate family member” as defined in Rule 5130(i)(5) or a “family member” as defined in Rule 202(a)(11)(G)-1(d)(6) under the Investment Advisers Act of 1940 (“Advisers

Act”) for the entity to be considered a family investment vehicle for purposes of Rule 5130.

Dechert 1, Dechert 2 and SIFMA state that the proposed limitation ignores practical realities of how family offices operate and is contrary to FINRA’s stated goal of harmonizing Rule 5130 with the Advisers Act’s treatment of family offices. Dechert 1 and Dechert 2 state that family offices often hire investment professionals that are not family members to provide investment advice based on delegated authority. Moreover, they note that the Commission, in adopting the Family Office Rule under the Advisers Act, recognized that non-family members that are integral to the functioning of the family office, including investment professionals that are hired by the family office, should be able to invest alongside family members in order to align their interests with the interests of the family.

FINRA does not believe that the proposed limitation serves any meaningful purpose given the Commission’s express recognition that investment professionals that are non-family members may provide investment advice to family offices and invest together with family members in order to have aligned interests. In addition, FINRA’s current definition of “family investment vehicle” allows investments by non-family members in such an entity,¹⁵ without placing any limitations on the person with the authority to make investment decisions for the entity. Therefore, in this Partial Amendment No. 1, FINRA is revising proposed Rule 5130(i)(4) to remove the proposed limitation.

Foreign Public Investment Companies

Proposed Rule 5130(c)(6) provides that a foreign public investment company that is formed for the specific purpose of investing in new issues would not be eligible for an

¹⁵ The definition of “immediate family member” under FINRA Rule 5130 includes any individual who is materially supported by the family, which could encompass non-family members. See FINRA Rule 5130(i)(5).

exemption. The ABA suggests that FINRA modify the proposed condition to provide that the investment company may not be formed for the specific purpose of permitting restricted persons to invest in new issues, which is more narrowly tailored to address the concerns Rule 5130 is designed to address while preserving a foreign public investment company's flexibility to make portfolio decisions. FINRA agrees with the comment by the ABA regarding the scope of the proposed condition regarding new issue investments by foreign public investment companies. In this Partial Amendment No. 1, FINRA is revising proposed Rule 5130(c)(6) to narrow the scope of the condition to provide that a foreign public investment company may not be formed for the specific purpose of permitting restricted persons to invest in new issues. This change also impacts an identical exemption in Rule 5131(b)(2).

Foreign Employee Retirement Benefits Plans

Proposed Rule 5130(c)(8) provides an exemption for foreign employee retirement benefits plans, subject to specified conditions. SIFMA requests that the proposed exemption be extended to employee retirement benefits plans organized in the United States that do not otherwise qualify for an exemption under the current provisions of Rule 5130 relating to Employee Retirement Income Security Act benefits plans and state or municipal government benefits plans. FINRA agrees with SIFMA's comment, which is also consistent with FINRA staff's prior exemptive relief to such plans. In this Partial Amendment No. 1, FINRA is revising proposed Rule 5130(c)(8) to extend the exemption to employee retirement benefits plans organized in the United States that meet the proposed conditions. In addition, this change impacts a corresponding exemption to Rule 5131(b)(2).

Foreign Offerings

Proposed Rule 5130(i)(9) excludes from the definition of "new issue" offerings made under Regulation S of the Securities Act or otherwise made outside of the United States or its territories. SIFMA and the ABA request that FINRA clarify the scope of the exclusion, including in situations where shares offered and sold in a foreign offering are concurrently registered for sale in the United States or where foreign non-member broker-dealers participating in an underwriting syndicate independently allocate shares to non-U.S. persons.

The proposed blanket exclusion from the definition of "new issue" is limited to a foreign offering, pursuant to Regulation S or otherwise, where shares in the offering are not concurrently registered for sale in the United States. While shares in a foreign offering that are concurrently registered for sale in the United States would not be categorically excluded from the definition of "new issue" under Rules 5130 and 5131, FINRA does not believe that the concerns the rules are

designed to address are implicated where foreign non-member broker-dealers that are participating in an underwriting syndicate with members are independently allocating new issues to non-U.S. persons.

In this Partial Amendment No. 1, FINRA is revising proposed Rule 5130(i)(9) to clarify that the exclusion for foreign offerings does not extend to shares of such offerings that are concurrently registered for sale in the United States. This change will also impact the definition of “new issue” under Rule 5131.¹⁶ This Partial Amendment No. 1 also adds Supplementary Material .01 to Rule 5130 and Supplementary Material .05 to Rule 5131 to clarify that the rules are not intended to restrict new issue allocations to non-U.S. persons by foreign non-member broker-dealers participating in the underwriting syndicate, provided that such allocation decisions are not made at the direction or request of a member or an associated person of a member.

Issuer-Directed Securities

Proposed Rules 5130(d)(1) and (d)(2) expand the exclusion for issuer-directed securities to allocations directed by affiliates and selling shareholders of the issuer, which is consistent with the issuer-directed provision in current Rule 5131.01.

SIFMA requests that FINRA revise current Rule 5131.01 and proposed Rules 5130(d)(1) and (d)(2) to clarify that a single affiliate or a single selling shareholder may direct securities. The ABA requests that FINRA also amend current Rule 5130(d)(1)(B), which relates to issuer-directed allocations to broker-dealer personnel, or members of their immediate family, who are employees or directors of the issuer, the issuer’s parent, or a subsidiary of the issuer or the issuer’s parent, to expressly recognize employees or directors of franchisees of such entities.

¹⁶ Rule 5131(e)(7) defines the term “new issue” by reference to Rule 5130(i)(9).

In response to the comments, in this Partial Amendment No. 1, FINRA is revising current Rule 5131.01 and proposed Rules 5130(d)(1) and (d)(2) to make a technical change to clarify that the issuer-directed provisions apply to securities directed by a single affiliate or a single selling shareholder. Further, in this Partial Amendment No. 1, FINRA is amending current Rule 5130(d)(1)(B) to expressly recognize employees or directors of a franchisee in a franchisor/franchisee relationship.

Lock-Up Agreements

Current Rule 5131(d)(2) requires that any lock-up agreement applicable to the officers and directors of an issuer entered into in connection with a new issue stipulate that, at least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the book-running lead manager must notify the issuer of the impending release or waiver and the impending release or waiver must be announced through a major news service. The rule provides an exception where the release or waiver is for a transfer that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor.

The ABA suggests that FINRA eliminate the "consideration" element for purposes of the exception to the rule. By way of example, the ABA notes that it may be difficult to ascertain whether a transfer is for "consideration" in certain situations involving transfers to immediate family members. The ABA also requests that FINRA codify guidance published in Regulatory Notice 10-60 (November 2010) regarding disclosure of a release or waiver in a publicly filed registration statement.

FINRA continues to believe that the lack of consideration (that is, where there is no exchange of something of value) is relevant for purposes of satisfying the exception to the public

announcement requirement under Rule 5131(d)(2). However, FINRA agrees with the ABA that it may be difficult to determine whether a transfer is for consideration in situations involving transfers to immediate family members. Moreover, FINRA does not believe that a transfer of securities to an immediate family member who is subject to the same lock-up restrictions as the transferor necessitates a public announcement. Therefore, in this Partial Amendment No. 1, FINRA is amending current Rule 5131(d)(2)(B) to extend the exception to transfers to immediate family members as defined in Rule 5130(i)(5), provided that the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor. In addition, in this Partial Amendment No. 1, FINRA is amending current Rule 5131.03 to provide that the disclosure of a release or waiver in a publicly filed registration statement in connection with a secondary offering satisfies the requirement for an announcement through a major news service, which codifies the prior guidance published in Regulatory Notice 10-60.

SPACs

Rule 5130(i)(9) currently excludes from the definition of “new issue” offerings of business development companies, direct participation programs and real estate investment trusts. FINRA excluded offerings of these entities based on the fact that their securities typically commence trading at the public offering price with little potential for trading at a premium because their assets at the time the initial public offering trades consist of the capital they have raised through the offering process. Moreover, FINRA states that if there is a premium, it is generally small.

FINRA states in its filing that a SPAC is a blind pool that offers units in an SEC-registered initial public offering (“IPO”) to investors for the purpose of completing an acquisition of an existing private company in the future. FINRA also states that the IPO consists

of common stock of the SPAC and typically includes a warrant to purchase common stock of the SPAC in the event that the SPAC completes an acquisition. The SPAC has generally 18 months to 24 months after the IPO to find a suitable target and sign a purchase agreement to acquire the target company. FINRA also states that SPACs are generally focused on a particular industry segment, and they hire management in those areas to explore and evaluate acquisition opportunities.

FINRA further states that the money raised by a SPAC from the issuance of units in an IPO is deposited in a trust account that is funded with an amount of money equaling the total of the proceeds from the IPO (less certain offering expenses). Because a SPAC's assets at the time of the IPO consist of the capital raised through the offering process (less certain offering expenses), FINRA states that there is little potential for SPACs to trade at a premium at the time of the IPO prior to signing an acquisition or merger agreement with a suitable target company. Moreover, FINRA states that SPACs rarely trade at a premium, and if there is a premium, it is generally small.

The ABA requests that FINRA consider excluding offerings of SPACs from the definition of "new issue" because such offerings have similar trading characteristics to offerings of other entities that FINRA has already excluded from the definition of "new issue," including offerings of registered closed-end investment companies, business development companies, direct participation programs and real estate investment trusts.

FINRA agrees that offerings of SPACs have similar characteristics to other offerings that are currently excluded from the definition of "new issue" and, thus, offerings of SPACs should also be excluded. In this Partial Amendment No. 1, FINRA is revising proposed Rule 5130(i)(9) to exclude offerings of SPACs. As noted above, FINRA states that this change will also impact

the definition of “new issue” under Rule 5131 because the term has the same meaning under both rules.

Owners of Broker-Dealers

Proposed Rule 5130(i)(10)(E) excludes sovereign entities from the scope of owners of broker-dealers. Proposed Rule 5130(i)(11) defines a “sovereign entity” as a sovereign nation or a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation. The ABA requests that FINRA make a technical change to the proposed definition to also include other vehicles owned or controlled by a sovereign nation that are created for the purpose of making investments for the benefit of the sovereign nation. FINRA is revising proposed Rule 5130(i)(11) in this Partial Amendment No. 1 to make this technical change.

Rule 5130(i)(10)(E) currently includes as restricted persons any person listed, or required to be listed, in Schedule C of Form BD that has an ownership interest above specified thresholds. FINRA (then NASD) originally included the reference to Schedule C because it shows any additions, deletions and other changes to Schedules A and B of Form BD. SIFMA requests that the reference to Schedule C be removed from Rule 5130(i)(10)(E) because it is superfluous. In this Partial Amendment No. 1, FINRA is deleting from proposed Rule 5130(i)(10)(E) the reference to persons listed in Schedule C of Form BD because currently the changes made on Schedule C are reflected in the Central Registration Depository system through the composite Schedules A and B.

III. Discussion and Commission Findings

After careful review of the proposal and the comment letters, the Commission finds that the proposed rule change, as modified by Partial Amendment No. 1, is consistent with the

requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹⁷ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 15A(b)(6) of the Act,¹⁸ which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issues, brokers, or dealers. The Commission also finds that the proposed rule change, as amended, is consistent with Section 15A(b)(9) of the Act, which requires that FINRA rules not impose any burdens on competition not necessary or appropriate in furtherance of the purposes of the Act.¹⁹

FINRA states that the proposed rule change, as modified by Partial Amendment No. 1, will further these purposes by promoting capital formation and aiding member compliance efforts while maintaining the integrity of the public offering process and investor confidence in the capital market. FINRA also states that the proposed rule change to Rules 5130 and 5131 will remove unnecessary impediments to capital formation and lessen burdens in the public offering process. Specifically, FINRA states that the proposed rule change will reduce both the costs and uncertainty in determining whether an investor is subject to the restrictions of Rules 5130 and 5131. FINRA states that the proposed rule change also may increase the pool of investors eligible to purchase new issues and, thus, encourage capital formation. Moreover, the proposed

¹⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁸ 15 U.S.C. 78o-3(b)(6).

¹⁹ 15 U.S.C. 78o-3(b)(9).

rule change creates two alternative conditions that a qualifying foreign investment company have \$100 or more direct investors at 1,000 or more indirect investor. These proposed alternative conditions would provide additional flexibility to foreign investment companies to demonstrate their eligibility for the exemption, and thereby enhance their ability to purchase new issues. The proposed rule change would also further the above purposes by clarifying the scope of Rule 5130 and 5131 by excluding Regulation S offerings and other offering made outside the United States or its territories from the scope of the rules. The proposed rule change would also harmonize Rule 5130 and 5131 with other FINRA rules relating to securities offerings, FINRA Rules 5110 and 5121, which currently exclude foreign offerings. FINRA believes that the proposed rule change will remove the burdens associated with complying with both U.S. and foreign regulatory regimes relating to public offerings and will lead to an increase in the pool of eligible investors for offshore offerings of new issues without undermining the fairness of U. S. public capital markets. FINRA believes that an increase in the pool of eligible investors could lead to a lower cost of capital for issuers engaged in foreign offerings.

To further the purposes of Rules 5130 and 5131, the proposed change would also align the issuer-directed provisions of Rules 5130 and 5131, provide regulatory consistency across the rules, and remove the compliance costs of applying different standards.

FINRA also proposes to exclude “unaffiliated charitable organizations” from the definition of “covered non-public company,” stating that the concerns addressed by the rules are not implicated with respect to executive officers and directors of charitable organizations that are not affiliated with a member. According to FINRA, this should ease the burden on the firms as they will no longer be required to consider whether an investment banking relationship exists vis-à-vis the member and an unaffiliated charitable organization when an individual with a

beneficial interest in an account is an executive officer or director (or materially supported by such a person) of such an organization.

FINRA also proposes to add an anti-dilution provision to Rule 5131 to ameliorate the current inconsistency between the Rules 5130 and 5131 in terms of equity ownership interest. The proposed rule change would add an anti-dilution provision to Rule 5131 (similar to that of Rule 5130) to address the unintentional result of officers or directors of public companies and covered non-public companies may experience diminished ownership interest upon a public offering and a transfer of wealth from them to those investors that are able to purchase shares in the new offering.

FINRA does not believe that the proposed rule change, as modified by Partial Amendment No. 1, will result in any burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act. FINRA also believes that the proposed rule change, as modified by Partial Amendment No. 1 will remove unnecessary impediments to capital formation and lessen burdens in the public offering process. Thus, the proposed rule change, as modified by Partial Amendment No. 1, strikes the appropriate balance by promoting capital formation and aiding member compliance efforts while maintaining the protections that Rules 5130 and 5131 are designed to provide. Consequently, the Commission finds that the proposed rule change is designed to promote capital formation and aid member compliance efforts, while maintaining the integrity of the public offering process and investor confidence in the capital markets.

For these reasons, the Commission finds that the proposed rule change, as modified by Partial Amendment No. 1, is consistent with Sections 15A(b)(6) and 15A(b)(9) of the Act and the rules and regulations thereunder applicable to a national securities association.

IV. Accelerated Approval of Proposed Rule Change, as Modified by Partial Amendment No. 1.

The Commission finds good cause to approve the proposed rule change, as modified by Partial Amendment No. 1, prior to the 30th day after the date of publication of notice of the filing of Partial Amendment No. 1 in the Federal Register. As discussed above, the proposed rule change, as modified by Partial Amendment No. 1, would exempt additional persons from the scope of these rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments, and exempt certain types of offerings from the scope of these rules. As such, the proposed rule change, as modified by Partial Amendment No. 1, would promote capital formation and aid member compliance efforts while maintaining the protections that Rules 5130 and 5131 are designed to provide (i.e., maintaining the integrity of the public offering process and investor confidence in the capital markets).

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²⁰ to approve the proposed rule change, SR-FINRA-2019-022, as modified by Partial Amendment No. 1, on an accelerated basis.

V. Solicitation of Comments on Partial Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Partial Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

²⁰ 15 U.S.C. 78s(b)(2).

- Send an email to rule-comments@sec.gov. Please include File Number SR-FINRA-2019-022 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2019-022. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-FINRA-2019-022 and should be submitted on or before **[INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]**.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act²¹ that the proposed rule change, as modified by Partial Amendment No. 1 (SR-FINRA-2019-022) be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Jill M. Peterson,

Assistant Secretary.

²¹ Id.

²² 17 CFR 200.30-3(a)(12).

